

Financial Statements

**Tuscola County Community
Mental Health Authority**

Caro, Michigan

September 30, 2004



Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Tuscola County Community Mental Health	County Tuscola
Audit Date 9/30/04	Opinion Date 11/17/04	Date Accountant Report Submitted to State: 3/25/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

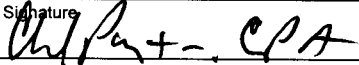
1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☒ Yes ☐ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ Yes ☐ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) ROSLUND, PRESTAGE & CO., PC, CPA'S			
Street Address 308 GRATIOT AVENUE		City ALMA	State MI
Accountant Signature 		ZIP 48801	Date 3/25/05

Tuscola County Community Mental Health Authority
Table of Contents
September 30, 2004

Independent Auditor's Report

Management's Discussion and Analysis I - VII

Basic Financial Statements:

Government-wide Financial Statements:

Statement of Net Assets 1

Statement of Activities 2

Fund Financial Statements:

Balance Sheet – Governmental Funds 3

Reconciliation of Fund Balances on the Balance Sheet for
Governmental Funds to Net Assets of Governmental
Activities on the Statement of Net Assets 4

Statement of Revenues, Expenditures and Changes in Fund
Balances – Governmental Funds 5 - 6

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances of Governmental Funds to the
Statement of Activities 7

Statement of Net Assets – Proprietary Funds 8

Statement of Revenues, Expenses and Changes in Fund
Net Assets – Proprietary Funds 9

Statement of Cash Flows – Proprietary Funds 10

Notes to the Financial Statements 11 - 27

Required Supplemental Information:

Budgetary Comparison Schedules 28

Other Supplemental Information:

Individual Fund Statements:

General Fund – Statement of Expenditures 29 – 30

Government Auditing Standards Audit Report 31 – 32



INDEPENDENT AUDITOR'S REPORT

Tuscola County Community Mental Health Authority
Caro, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Tuscola County Community Mental Health Authority (the Authority), as of and for the year ended September 30, 2004, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amount and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Authority as of September 30, 2004, and the respective changes in financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 17, 2004 on our consideration of the Authority's internal control over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages I - VII and budgetary comparison information on page 28 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The other supplemental information listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Authority. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Roslund, Prestage & Co, PC
Roslund, Prestage & Company, P.C.
Certified Public Accountants

November 17, 2004

MANAGEMENT'S DISCUSSION and ANALYSIS

Tuscola County Community Mental Health Authority

Management's Discussion and Analysis

For the year ended September 30, 2004

This section of the Tuscola County Community Mental Health Authority (TCCMHA) annual financial report presents management's discussion and analysis of financial performance for the year ended September 30, 2004. This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities, and to identify significant changes in financial position and results of operations. Please read this section in conjunction with the auditor's report, financial statements, notes to financial statements and supplemental information taken as a whole.

FINANCIAL HIGHLIGHTS

- The current financial position, which is the excess of current assets over current liabilities, of TCCMHA was a positive \$369 thousand.
- The net change in capital assets was an increase of \$1.1 million. TCCMHA increased and strengthened its capital position in fiscal 2004. Expansion included addition of office space to accommodate growing clinical programs. Manufacturing space was also added at Cass Valley Enterprises, a division of TCCMHA, due to growing industrial operations and anticipated production increases resulting from new contracts.

OPERATING HIGHLIGHTS

TCCMHA continued its commitment to the consumers of Tuscola County.

- A grant was approved by the Michigan Department of Community Health (MDCH) to develop and produce a series of videos relating to recipient rights. The primary goal of this project, which will be completed in fiscal 2005, is to create a video series that will assist people with mental illness and developmental disabilities by adding another resource to enhance consumer independence. Once completed, the video series will be distributed throughout the state.
- Planning began to open a transitional home which would also give consumers the opportunity to become more independent. The home would provide training and support to consumers to learn skills necessary to live on their own.
- Cass Valley Enterprises was awarded a new contract with the Department of Defense to produce combat identification panels. These panels are used on military vehicles to prevent "friendly" fire. Cass Valley Enterprises also met the necessary requirements to become governmental ISO 9001-2000 certified.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

OVERVIEW OF FINANCIAL STATEMENTS

Basic financial statements, in accordance with generally accepted accounting principles (GAAP) according to GASB 34, require the presentation of two types of financial statements. These are authority-wide financial statements and fund financial statements.

Authority-wide financial statements include the statement of net assets and the statement of activities. These provide both long-term and short-term information, and present a broad view of the overall financial status in a manner similar to a private sector business. Information presented in these statements is on the accrual basis of accounting. Long-term assets are capitalized and depreciated. Long-term debt is recorded as a liability. Revenues are recorded when earned and expenses recorded when incurred, without regard to the timing of cash receipts or disbursement.

The statement of net assets includes all assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of improving or deteriorating financial position. The statement of activities presents information showing how net assets changed during the year as a result of operating activity.

Fund financial statements contain individual groups of related accounts and are used to report current assets, current liabilities, fund balance, revenues and expenditures for specific activities or funds segregated for legal requirements or other governmental objectives. These are presented in more detail as compared to the authority-wide statements. The fund financial statements are reported on the modified accrual basis of accounting. Only those assets that are measurable and currently available are reported. Liabilities are recognized only to the extent that they are normally expected to be paid with current financial resources. Purchased capital assets are reported as expenditures in the year of acquisition. Issuance of debt is recorded as a financial resource with current year payment of principal and interest recorded as an expenditure. Fund financial statements are essentially identical in presentation, format and content to prior year annual financial reports.

Fund financial statements are divided into two categories. These are general fund financial statements and proprietary fund financial statements.

General fund financial statements show how the community mental health supports and services programs were financed in the short term, along with what remains for future spending.

Proprietary fund financial statements show internal service funds reserved for risk management. These funds are held as a self-funded insurance risk reserve to protect against unanticipated current and future financial exposures related to specialty supports and services at-risk contracts.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

SUMMARY OF NET ASSETS

The following summarizes the assets, liabilities and net assets on an authority-wide basis as of September 30, 2004 and 2003.

Summary of Net Assets

As of September 30, 2004 and 2003

(In \$000s)

	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>
<u>Assets</u>			
Current assets	\$ 2,223	\$ 2,894	(672)
Restricted assets	459	689	(229)
Capital assets	2,188	1,096	1,092
Total assets	<u><u>\$ 4,869</u></u>	<u><u>\$ 4,679</u></u>	<u><u>\$ 191</u></u>
<u>Liabilities</u>			
Current liabilities	\$ 1,854	\$ 1,871	(18)
Noncurrent liabilities	1,057	661	395
Total liabilities	<u><u>2,911</u></u>	<u><u>2,533</u></u>	<u><u>378</u></u>
<u>Net Assets</u>			
Investment in capital assets	1,330	674	656
Restricted for capital purposes	-	236	(236)
Restricted for risk management	52	149	(98)
Unrestricted	577	1,087	(510)
Total net assets	<u><u>1,959</u></u>	<u><u>2,146</u></u>	<u><u>(187)</u></u>
Total liabilities and net assets	<u><u>\$ 4,869</u></u>	<u><u>\$ 4,679</u></u>	<u><u>\$ 191</u></u>

Current financial position is defined as the excess of current assets over current liabilities. A positive current financial position is an indicator of financial strength and an increase in current financial position is an indicator of improving financial position. The current financial position was a positive \$369 thousand.

Current assets consist of cash and investments, accounts receivable, amounts due from others and prepaid expenses. These are available for current operations and to pay current obligations. Current liabilities include accounts payable, accrued payroll, related taxes and benefits, amounts due to others and deferred revenue.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

At year-end, current liabilities include \$621 thousand of unspent Medicaid funding that is due to the PIHP under the local service area subcontract agreement.

Restricted assets consist of cash, investments and accrued interest receivable. These assets are restricted for payment of compensated absences, restricted for capital asset purposes (funded depreciation), and restricted for risk management.

The assets restricted for risk management are related to the risk obligations of the state general fund risk contract maintained directly with the state. At year-end, the balance in this account was \$52 thousand.

Capital assets consist of property and equipment having an estimated useful life of more than one year. Under the provisions of GASB 34, these assets are now included on the statement of net assets at their original book value, restated to be net of the accumulated depreciation that would have otherwise been reported in prior years. As of the beginning of fiscal 2004, capital assets having an original book value of \$2.4 million were recorded, net of restated accumulated depreciation of \$1.3 million, for a beginning net book value of \$1.1 million.

In fiscal 2004, \$1.3 million was expended for capital acquisitions. Depreciation expense on previously existing and newly acquired capital assets was \$227 thousand. The net change in capital assets was an increase of \$1.1 million for the year. When capital expenditures exceed depreciation expense, the net increase represents an investment or expansion of capital resources.

As of year-end, the net book value of capital assets was 61% of the original book value. This percentage is a measure of the relative age of property and equipment. If property and equipment is relatively new, this percentage will be high. Conversely, if the percentage is low, it means that property and equipment is relatively old.

Noncurrent liabilities consist of long-term debt related to the acquisition of capital assets and the liability for compensated absences. Principal payments for the year were \$94 thousand. The liability for compensated absences includes vested vacation and sick pay obligations and certain deferred compensation amounts. The compensated absences liability at year end was \$302 thousand.

Restricted net assets include investment in capital assets, net of related debt, and amounts restricted for capital purposes and for risk management. These were discussed above.

Unrestricted net assets at the end of the year were \$577 thousand. Unrestricted net assets were 12% of total assets, down from 23% from the prior year.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

SUMMARY OF ACTIVITIES

The following summarizes the revenue, expenses and change in net assets on an authority-wide basis for the years ended September 30, 2004 and 2003.

Summary of Activities

For the years ended September 30, 2004 and 2003

(In \$000s)

	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>	<u>% Change</u>
<u>REVENUE</u>				
Medicaid specialty supports and services	\$ 10,420	\$ 9,096	1,325	15%
State general fund priority populations	1,824	1,814	10	1%
Adult benefits waiver supports and services	178	-	178	
Program service revenue	212	438	(226)	-52%
Grants and earned contracts	429	244	185	76%
Cass Valley Enterprises	1,071	2,333	(1,262)	-54%
County appropriation	288	288	-	0%
Interest income	19	33	(14)	-41%
Other income	14	19	(5)	-28%
TOTAL REVENUE	14,456	14,265	191	1%
<u>EXPENSE</u>				
Personnel expense	6,316	5,853	463	8%
Operating expense	7,789	8,357	(568)	-7%
Local funds contributed to State	283	283	-	0%
Interest expense	27	7	20	273%
Depreciation	227	236	(9)	-4%
TOTAL EXPENSE	14,642	14,736	(93)	-1%
EXCESS OF REVENUE OVER EXPENSE	\$ (187)	\$ (471)		

Excess of expenses over revenue from activities for the current year was \$187 thousand or 1% of revenue.

Medicaid specialty supports and services revenue represents 72% of total revenue. Beginning in fiscal 2003, the Michigan Department of Community Health began contracting for Medicaid specialty supports and services through designated Prepaid Inpatient Health Plans (PIHPs) in regional geographic areas. TCCMHA is affiliated with Bay-Arenac Behavioral Health as the designated PIHP for a region consisting of Bay, Arenac, Huron, Montcalm, Shiawassee, and Tuscola counties. TCCMHA subcontracts for Medicaid funding through the PIHP. This subcontract is on a net cost basis.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

Unspent Medicaid subcontract funds of \$74 thousand are not revenue and are shown as amounts due to the PIHP as discussed above.

State general fund priority population revenue (formula funding) represents 13% of total revenue. This funding is established by MDCH as a part of the legislative appropriation process under the Michigan Mental Health Code and is used to provide supports and services to indigent priority populations, including state facility utilization and other allowable expenses. Current year revenue includes \$79 thousand of prior year deferred revenue and \$85 thousand of funds transferred from Montcalm Center for Behavioral Health. There were no unspent state general funds in the current year.

Adult benefits waiver supports and services revenue represents 1% of total revenue. The adult benefits waiver program was new in fiscal 2004. This program is funded by state general funds and provides health insurance coverage to uninsured childless adults with countable incomes at or below 35% of the federal poverty level.

Program service revenue includes charges for services for consumers not covered by Medicaid risk contracts or state general fund revenue sources. These represent 1% of total revenue.

Grants and earned contract revenue includes revenue sources for which the use of funds is restricted to a specific purpose. These represent 3% of total revenue.

County appropriation revenue, interest income and other local income are available to meet state matching fund requirements. These revenue sources constitute 2% of revenue.

Cass Valley Enterprises revenue includes revenue earned through various industrial operations contracts. These revenue sources constitute 7% of revenue.

Total expense of \$14.6 million has decreased \$93 thousand compared to the prior year.

Personnel expense is 43% of total expense and has increased primarily due to a 16% increase in benefits.

Operating expense is 53% of total expense and has decreased. The largest contributing factor is decreased sales and production costs at Cass Valley Enterprises.

Interest expense is less than 1% of total expenses and has increased due to financing the addition of capital resources.

Tuscola County Community Mental Health Authority
Management's Discussion and Analysis
For the year ended September 30, 2004

FUTURE OUTLOOK

Once again, the State of Michigan is struggling to balance huge budget deficits. Federal deficits are placing additional pressures on Medicaid funding. The effect of these on future funding for community mental health and specialty supports and services is unknown.

Management expects revenues to be flat at best. Support and service demand is expected to increase together with inflationary cost pressures. Budgetary and operating priorities for next year and beyond include the following:

- Expansion of Cass Valley Enterprises operations through new government contracts
- Elimination of debt through the expansion of Cass Valley Enterprises and other means
- Maximizing collaborative efforts throughout the affiliation to increase efficiency and economies of scale

As always, questions, comments and suggestions are welcomed from interested parties and the general public. These can be directed to management.

**BASIC FINANCIAL STATEMENTS -
GOVERNMENT WIDE FINANCIAL STATEMENTS**

Tuscola County Community Mental Health Authority
Statement of Net Assets
September 30, 2004 and 2003

	<u>Governmental Activities</u>	
	<u>2004</u>	<u>2003</u>
Assets		
Current assets		
Cash and cash equivalents	\$1,233,792	\$1,885,284
Accounts receivable	167,781	395,647
Due from other governmental units	197,587	180,499
Inventory	450,247	303,417
Prepaid items	<u>173,093</u>	<u>129,478</u>
Total current assets	<u>2,222,500</u>	<u>2,894,325</u>
Noncurrent assets		
Cash and cash equivalents - restricted	459,044	688,502
Capital assets - depreciable, net	2,070,260	1,008,347
Capital assets - land	<u>117,600</u>	<u>87,600</u>
Total noncurrent assets	<u>2,646,904</u>	<u>1,784,449</u>
Total assets	<u>4,869,404</u>	<u>4,678,774</u>
Liabilities		
Current liabilities		
Accounts payable	619,108	576,030
Accrued wages and other payroll liabilities	394,966	307,344
Deferred revenue	800	81,285
Due to other governmental units	735,927	843,094
Notes payable, current portion	<u>103,178</u>	<u>63,746</u>
Total current liabilities	<u>1,853,979</u>	<u>1,871,499</u>
Noncurrent liabilities		
Notes payable, net of current portion	754,638	358,459
Compensated absences	<u>302,153</u>	<u>302,834</u>
Total noncurrent liabilities	<u>1,056,791</u>	<u>661,293</u>
Total liabilities	<u>2,910,770</u>	<u>2,532,792</u>
Net Assets		
Invested in capital assets, net of related debt	1,330,044	673,742
Restricted for capital purposes	-	236,254
Restricted for risk management	51,827	149,414
Unrestricted	<u>576,763</u>	<u>1,086,572</u>
Total net assets	<u>\$1,958,634</u>	<u>\$2,145,982</u>

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Activities
For the Year Ended September 30, 2004 and 2003

Functions	Program Revenues			Net (Expense) Revenue and Change in Net Assets	2003
	Expenses	Charges for Services	Operating Grants and Contributions		
Governmental activities					
Health & Welfare - Mental Health	<u>\$14,643,772</u>	<u>\$10,878,461</u>	<u>\$3,557,894</u>	(\$207,417)	(\$503,545)
General revenues					
Unrestricted investment earnings				19,356	31,663
Restricted investment earnings				713	1,204
Total general revenues				20,069	32,867
Transfers to affiliates				-	(606,213)
Change in net assets				(187,348)	(1,076,891)
Net assets - beginning of year				2,145,982	3,222,873
Net assets - end of year				<u>\$1,958,634</u>	<u>\$2,145,982</u>

See Accompanying Notes To Financial Statements

FUND FINANCIAL STATEMENTS

Tuscola County Community Mental Health Authority
Balance Sheet
Governmental Funds
September 30, 2004 and 2003

	General Fund	
	2004	2003
Assets		
Cash and cash equivalents	\$1,233,792	\$1,885,284
Accounts receivable	167,781	395,647
Due from other funds	95,506	-
Due from other governmental units	197,587	180,499
Inventory	450,247	303,417
Prepaid items	173,093	129,478
Restricted cash	311,711	688,502
Total assets	<u>\$2,629,717</u>	<u>\$3,582,827</u>
Liabilities		
Accounts payable	\$619,108	\$576,030
Accrued wages and other payroll liabilities	394,966	307,344
Due to other funds	-	149,414
Deferred revenue	800	81,285
Due to other governmental units	735,927	843,094
Total liabilities	<u>1,750,801</u>	<u>1,957,167</u>
Fund balances		
Reserved for inventory and prepaid items	623,340	432,895
Reserved for compensated absences	302,153	302,834
Reserved for capital purposes	-	236,254
Unreserved	(46,577)	653,677
Total fund balances	<u>878,916</u>	<u>1,625,660</u>
Total liabilities and fund balances	<u>\$2,629,717</u>	<u>\$3,582,827</u>

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Reconciliation of Fund Balances on the Balance Sheet for Governmental Funds
to Net Assets of Governmental Activities on the Statement of Net Assets
For the Year Ended September 30, 2004

Total fund balance - governmental funds	\$878,916
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Amounts reported for governmental activities in the statement of
net assets are different because:

Capital assets used in governmental activities are not financial resources
and therefore are not reported in the funds.

Add: capital assets	3,590,466
Deduct: accumulated depreciation	(1,402,606)

An internal service fund is used by management to cover the risk of
overspending the Managed Care Specialty Services Program contract.
The assets and liabilities of the internal service fund are included in
governmental activities in the statement of net assets.

Add: net assets of governmental activities accounted for in the internal service fund	51,827
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Some liabilities are not due and payable in the current period and
therefore are not reported in the funds. Those liabilities consist of:

Deduct: Notes payable	(857,816)
Deduct: Compensated absences	(302,153)

Net assets of governmental activities	<u>\$1,958,634</u>
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See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Revenues, Expenditures and Changes in Fund Balances
All Governmental Fund Types
For the Year Ending September 30, 2004 and 2003

	General Fund	
	2004	2003
REVENUES		
State grants		
State general fund - MDCH Contract	\$1,823,895	\$1,813,942
Adult Benefit Waiver	178,032	-
Title XX	5,843	5,843
Total state grants	<u>2,007,770</u>	<u>1,819,785</u>
Federal grants	<u>176,650</u>	<u>191,019</u>
Contributions - local units		
County appropriations	<u>288,243</u>	<u>288,243</u>
Charges for services		
Medicaid - affiliate	10,420,308	9,095,619
Medicaid - other	70,380	60,941
Client and third party pay	211,763	210,257
Contract revenue	<u>176,010</u>	<u>213,881</u>
Total charges for services	<u>10,878,461</u>	<u>9,580,698</u>
Interest and rents		
Interest	19,356	31,663
Other revenue		
Cass Valley Enterprises	1,071,312	2,333,062
Other	<u>13,919</u>	<u>19,280</u>
Total other revenue	<u>1,085,231</u>	<u>2,352,342</u>
Total revenues	14,455,711	14,263,750

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Revenues, Expenditures and Changes in Fund Balances
All Governmental Fund Types
For the Year Ending September 30, 2004 and 2003

	General Fund	
	2004	2003
EXPENDITURES		
Health & welfare - mental health		
Personnel costs	\$6,315,941	\$5,809,600
Operating expenditures	8,071,542	8,639,471
Capital outlay	1,321,569	421,544
Debt service		
Interest	27,314	7,318
Principal	93,758	35,947
Total expenditures	15,830,124	14,913,880
Excess of revenues over expenditures	(1,374,413)	(650,130)
Other financing sources (uses)		
Loan proceeds	529,369	298,456
Operating transfers in (out) - internal service fund	98,300	(754,423)
Total other financing sources (uses)	627,669	(455,967)
Excess of revenues and other sources over (under) expenditures and other uses	(746,744)	(1,106,097)
Fund balance, October 1	1,625,660	2,731,757
Fund balance, September 30	\$878,916	\$1,625,660

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Reconciliation of the Statement of Revenues, Expenditures
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended September 30, 2004

Net change in fund balances - total governmental funds	(\$746,744)
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Amounts reported for governmental activities in the statement of activities
are different because:

Governmental funds report capital outlays as expenditures. However,
in the statement of activities, the cost of those assets is allocated over
their estimated useful lives as depreciation expense.

Add: capital outlay	1,321,569
Deduct: depreciation expense	(227,475)

An internal service fund is used by management to cover the risk of
overspending the Managed Care Specialty Services Program contract.
The net revenue (expense) of this fund is reported within governmental activities.

Add: net revenue (expense) from governmental internal service fund	(97,587)
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Payment of principal on long-term debt is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt).	93,758
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Fixed assets acquired by long term loans are shown as an expenditure and other financing source in the governmental funds. The other financing source must be removed from the statement of activities; principal payments are applied to the long term liability; interest expense is recognized as it accrues.	(529,369)
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Some expenses reported in the statement of activities do not require the
use of current financial resources and therefore are not reported as
expenditures in the funds.

Add: Decrease in accrual for compensated absences	681
Less: Loss on disposal of fixed assets	(2,181)

Change in net assets of governmental activities	<u>(\$187,348)</u>
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See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Net Assets
Proprietary Funds
September 30, 2004 and 2003

	<u>Internal Service Funds</u>	
	<u>2004</u>	<u>2003</u>
Assets		
Cash	\$147,333	-
Due from other funds	<u>-</u>	<u>\$149,414</u>
Total assets	<u>147,333</u>	<u>149,414</u>
Liabilities		
Due to other funds	<u>95,506</u>	<u>-</u>
Net assets		
Restricted for risk management	<u><u>\$51,827</u></u>	<u><u>\$149,414</u></u>

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended September 30, 2004 and 2003

	<u>Internal Service Funds</u>	
	<u>2004</u>	<u>2003</u>
Non-operating revenues		
Interest income	\$713	\$1,204
Operating transfers		
Operating transfers in (out) - general fund	(98,300)	754,423
Transfers to affiliates	<u>-</u>	<u>(606,213)</u>
Change in net assets	(97,587)	149,414
Net assets, beginning of year	<u>149,414</u>	<u>-</u>
Net assets, end of year	<u><u>\$51,827</u></u>	<u><u>\$149,414</u></u>

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2004 and 2003

	<u>Internal Service Funds</u>	
	<u>2004</u>	<u>2003</u>
Cash flows from operating activities	-	-
Cash flows from noncapital financial activities		
Operating transfers in (out)	\$146,620	\$605,009
Transfers to affiliates	-	(606,213)
Cash flows from investing activities		
Proceeds from interest earnings	<u>713</u>	<u>1,204</u>
Net increase (decrease) in cash	147,333	-
Cash and cash equivalents, beginning of year	<u>-</u>	<u>-</u>
Cash and cash equivalents, end of year	<u><u>\$147,333</u></u>	<u><u>-</u></u>
Reconciliation of operating income to net cash provided by (used for) operating activities:		
Operating income (loss)	-	-

See Accompanying Notes To Financial Statements

NOTES TO THE FINANCIAL STATEMENTS

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Tuscola County Community Mental Health Authority (the Authority) conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the significant accounting policies used by the Authority.

In June of 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Significant changes in the Statement include the following:

- A Management's Discussion and Analysis (MD&A) section providing an analysis of the Authority's overall financial position and results of operations.
- Financial statements prepared using full accrual accounting for all of the Authority's activities.
- A change in the fund financial statements to focus on major funds.

These and other changes are reflected in the accompanying financial statements (including the notes to the financial statements). The Authority has implemented the provisions of Statement No. 34 effective October 1, 2002.

Reporting Entity

The Authority operates as a Community Mental Health Authority under the provisions of Act 258 - Public Acts of 1974, as amended. The Authority provides funding for services in the areas of mental illness, developmental disabilities, and other related mental health needs for residents of Tuscola County.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational financial relationships that determine which of the governmental organizations are a part of the Authority's reporting entity, and which organizations are legally separate, component units of the authority. Based on the application of the criteria, the Authority does not contain any component units.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the Authority. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to consumers who purchase, use or directly benefit from services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

Government-Wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Authority considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

Modifications to the accrual basis of accounting include:

- Employees' vested annual leave is recorded as expenditures when utilized. The amount of accumulated annual leave unpaid at September 30, 2004, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is recognized when paid.
- Debt service expenditures and claims and judgments are recorded only when payment is due.

Proprietary Fund Financial Statements – The financial statements of the proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the internal service fund are charges to other funds for insurance services. Operating expenses for internal service funds include the cost of claims, administration and reinsurance. Any revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

The Authority reports the following major governmental and proprietary funds:

Governmental Funds

General Fund – This fund is the Authority’s primary operating fund. It accounts for all financial resources of the Authority, except those required to be accounted for in other funds.

Proprietary Funds

Internal Service Fund – This fund represents amounts set aside to fund the net uninsured exposure of potential shortfalls of risk contract revenues.

Comparative Data

Comparative total data for the prior year has been presented in order to provide an understanding of the changes in financial position and operations. Also, certain amounts presented in the prior year may have been reclassified in order to be consistent with the current year’s presentation.

Budgetary Data

Budgets are adopted by the Authority for all governmental funds. The budget is adopted and prepared on the modified accrual basis of accounting. The budget is also adopted at the function level. The budgeted revenues and expenditures for governmental fund types, as presented in this report, include any authorized amendments to the original budget as adopted.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Cash and Cash Equivalents

The Authority's cash and cash equivalents are considered to be cash on hand, money market funds, demand deposits and short-term investments with an original maturity of three months or less from the date of acquisition.

Michigan Compiled Laws, Section 129.91, authorized the Authority to deposit and invest in the accounts of Federally insured banks, credit unions, and savings and loan associations; bonds, securities and other direct obligations of the United States, or any agency or instrumentality of the United States; United States government or Federal agency obligation repurchase agreements; bankers' acceptance of United States banks; commercial paper rated by two standard rating agencies within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan. Financial institutions eligible for deposit of public funds must maintain an office in Michigan. The Authority's deposits are in accordance with statutory authority.

Receivables and Payables between Funds

Activity between funds that are representative of lending / borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to / from other funds" (i.e. the current portion of interfund loans) or "advances to / from other funds" (i.e. the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to / from other funds". Any residual balances outstanding between the governmental activities are reported in the government-wide financial statements as "internal balances".

Receivables

Accounts receivable in all funds report amounts that have arisen in the ordinary course of business and are stated net of allowances for uncollectible amounts.

Due from other governmental entities consist primarily of amounts due from the Michigan Department of Community Health, the State of Michigan and Tuscola County.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Inventory

Inventory is recorded at the lower of cost or market on a first-in, first-out basis. The cost is recorded as an expenditure at the time individual inventory items are consumed rather than when purchased.

Capital Assets

Capital assets, which include property, plant and equipment, are reported in the government activities column in the government-wide financial statements. Capital assets are defined by the government as individual assets with an initial cost equal to or more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

The Authority does not have infrastructure type assets.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during construction of capital assets is not capitalized. No interest expense was incurred during the current year.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements.

Capital assets of the Authority are depreciated using the straight line method over the following estimated useful lives:

Assets	Years
Land	N/A
Buildings and Improvements	20 – 30
Equipment and Furnishings	5 – 10
Computers	3
Vehicles	5

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Restricted Assets

Cash has been restricted for future payment of the compensated absences liability. These restricted assets are held in a separate cash account with local financial institutions.

Deferred Revenue

Deferred revenues arise when resources are received by the Authority before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Authority has a legal claim to the resources, the liability for deferred revenue is removed from the fund financial statements and government-wide financial statements, and revenue is recognized.

Governmental Fund – Fund Balance Reserves and Designations

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditure or (2) legally segregated for a specific future use. The reserves for related assets such as prepaid items are examples of the former. Reserves for compensated absences are examples of the latter.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Inpatient / Residential Cost Liability

The amount recorded for inpatient/residential liability is based on management's estimate. This estimate is based on 1) the number of clients at each facility, 2) the number of days each client is at each facility, and 3) the daily rate charged for each facility.

The Authority does not receive actual billings for these services until several months after the service date. Therefore, the liability is not liquidated within the normal 60 day period after year end. Also, the actual cost may vary from the estimated due to reimbursements from third party payors that are applied to the total cost before the billings are sent to the Authority.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

NOTE 2 – STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Information

Annual budgets are adopted at the function level and on a basis consistent with generally accepted accounting principles for all governmental funds. All annual appropriations lapse at fiscal year end. The Authority does not maintain a formalized encumbrance accounting system. The budgeted revenues and expenditures, as presented in this report, include any authorized amendments to the original budget as adopted.

Excess Of Expenditures Over Appropriations

P.A. 621 of 1978, Section 18(1), as amended, provides that a local unit shall not incur expenditures in excess of the amount appropriated.

During the year ended September 30, 2004, the Authority incurred expenditures in excess of the amounts appropriated as shown on page 28 of this report as unfavorable variances.

NOTE 3 – DETAIL NOTES

Cash and Investments

At September 30th the carrying amount of the Authority's cash and investments are as follows:

	2004	2003
Petty Cash	\$1,100	\$1,286
Checking and Savings accounts	724,289	425,413
State Investment Pool	967,447	2,147,087
Totals	\$1,692,836	\$2,573,786

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

At year end, the carrying amount of the Authority's cash deposits was \$724,289 and the bank balance was \$831,026. Of the bank balance, \$100,000 was covered by federal depository insurance and the remaining was uninsured and uncollateralized. The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Authority evaluates each financial institution with which it deposits government funds and accesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

A reconciliation of cash and cash equivalents as shown on the Statement of Net Assets follows:

	2004	2003
Cash and cash equivalents – current assets	\$1,233,792	\$1,885,284
Cash and cash equivalents – restricted assets	459,044	688,502
Total	\$1,692,836	\$2,573,786

Investments

The nature of mutual funds, bond funds, and investment pools does not allow for risk categorization in accordance with GASB Statement No. 3.

Investment	Carrying Value	Market Value
State Investment Pool	\$967,447	\$967,447

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Due from Other Governmental Units

Due from other governmental units as of September 30, consists of the following:

	2004	2003
State of Michigan – Medicaid	\$12,807	\$34,172
Department of Community Health – General Funding	85,000	-0-
County of Tuscola	72,061	72,061
Department of Community Health OBRA Grant	12,903	14,833
Various Other Governmental Units	14,421	12,471
Bay-Arenac Behavioral Health	395	46,962
Totals	\$197,587	\$180,499

Interfund Receivables and Payables

The amount of interfund receivables and payables at September 30, are as follows:

Fund	Due From Other Funds	Due To Other Funds
General Fund	\$95,506	-
Internal Service Fund	-	\$95,506
Totals	\$95,506	\$95,506

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Changes in Capital Assets

A summary of changes in the Authority's capital assets follows:

Assets	Beginning Balance	Additions	Disposals	Ending Balance
Land	\$87,600	\$30,000		\$117,600
Buildings and Improvements	577,497	1,050,495		1,627,992
Equipment and Furnishings	397,351	110,350	\$63,270	444,431
Computers	306,639		67,218	239,421
Vehicles	1,030,298	130,724		1,161,022
Sub-total	2,399,385	1,321,569	130,488	3,590,466
Accumulated Depreciation				
Buildings and Improvements	50,692	42,970		93,662
Equipment and Furnishings	252,721	33,405	61,089	225,037
Computers	286,807	16,903	67,218	236,492
Vehicles	713,218	134,197		847,415
Sub-total	1,303,438	227,475	128,307	1,402,606
Totals	\$1,095,947	\$1,094,094	\$2,181	\$2,187,860

Due to Other Governmental Units

Due to other governmental units as of September 30, consist of the following:

	2004	2003
State of Michigan	\$115,308	\$96,876
Bay-Arenac Behavioral Health	620,619	746,218
Totals	\$735,927	\$843,094

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Accrued Wages and Other Payroll Liabilities

This liability represents amounts paid to employees during October that was earned during September. Also included are employer payroll taxes.

Long-Term Debt – Compensated Absences

Authority policy allows full time employees to accumulate vacation and sick days at various rates, depending on the employee's length of service with the Authority. Amounts accumulated up to a maximum of 30 vacation days are to be paid to the employee and recognized as an expense either when annual leave time is used, or at the discretion of the Authority, upon termination of employment.

Employees also accumulate sick leave time at various rates, depending on the date of hire with the Authority. Amounts accumulated up to a maximum of 60 days are to be paid to the employee and recognized as an expense either when sick leave time is used, or at the discretion of the Authority, upon termination of employment.

As of September 30, 2004 and 2003, compensated absences liability was \$302,153 and \$302,834, respectively.

Long Term Debt – Notes Payable

Vehicle Loans

During the 2002 year, the Authority entered into four promissory note contracts with Community Bank in Caro, Michigan for the purchase of 10 vehicles. Payments are due monthly in the amount of \$3,312, including interest at the rate of 4.9% per annum. As of September 30, 2004, the balance of these loans total \$92,529.

During the 2003 year, the Authority entered into three promissory note contracts with Community Bank in Caro, Michigan for the purchase of five vehicles. Payments are due monthly in the amount of \$1,881, including interest at the rate of 4.9% per annum. As of September 30, 2004, the balance of these loans total \$59,330

During the 2004 year, the Authority entered into one promissory note contract with Community Bank in Caro, Michigan for the purchase of four vehicles. Payments are due monthly in the amount of \$1,212, including interest at the rate of 4.9% per annum. As of September 30, 2004, the balance of these loans total \$53,814.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Building Loan

During the 2003 year, the Authority entered into a promissory note contract with Mayville State Bank in Mayville, Michigan for the purchase of real property. Payments are due monthly in the amount of \$1,615, including interest at the rate of 4.05% per annum. As of September 30, 2004, the balance of the loan totals \$196,691.

During the 2004 year, the Authority entered into a promissory note contract with Mayville State Bank in Mayville, Michigan for the purchase of real property. Payments are due monthly in the amount of \$3,417, including interest at the rate of 3.9% per annum. As of September 30, 2004, the balance of the loan totals \$455,452.

The annual installments to pay principal and interest on obligations outstanding at September 30, 2004 are as follows, including total interest payments of \$223,596.

Year Ended September 30,	Amount
2005	\$137,241
2006	133,716
2007	104,866
2008	85,890
2009	62,612
2010 – 2014	301,940
2015 – 2018	255,147

The changes in long term liabilities during the 2004 fiscal year are as follows:

Liability	Balance October 1, 2003	Additions	Reductions	Balance September 30, 2004
Compensated Absences	\$302,834		(\$681)	\$302,153
Vehicle Loans	204,591	\$64,369	(63,287)	205,673
Building Loan	217,614	465,000	(30,471)	652,143
Totals	\$725,039	\$529,369	(\$94,439)	\$1,159,969

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Operating Leases

Tuscola County Community Mental Health Authority has entered into various operating leases for the use of real and personal property. Operating leases do not give rise to property rights or lease obligations, and therefore, the lease agreements are not reflected in the account groups.

The following is a schedule of future minimum rental payments required under the operating leases that have initial or remaining noncancelable lease terms as of September 30, 2004:

YEAR ENDING SEPTEMBER 30,	AMOUNT
2005	\$318,491
2006	327,921
2007	129,762
2008	42,653
2009	-0-
Thereafter	-0-

Retirement System

MERS - Substantially all of the employees of the Authority participate in the Michigan Municipal Employees Retirement System (MERS), a multiple employee defined benefit pension plan, administered by the State of Michigan.

Under this plan, employees contribute 5% of annual earnings. The amount of employer contributions is determined on a yearly basis. For the year ending September 30, 2004, employer contributions to this retirement plan was \$27,828.

For the 2005 fiscal year, employer contributions will be at the rate of 1.55% of eligible employee wages.

The actuarial accrued liability at December 31, 2003 (the date of the most recent available information) for the plan as a whole, determined through an actuarial valuation performed as of that date, was \$6.5 million. The plan's valuation assets at December 31, 2003 were \$7.2 million resulting in funding in excess of the actuarial accrued liability of \$.7 million. Valuation assets, determined by the actuary, are equal to reported fair value assets, adjusted for amortization of actuarial gains and losses.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Principal Financial Group - Effective October 1, 1997, the Authority was considered a new governmental entity, and voted to join an optional retirement plan instead of the Social Security system for full time employees 18 years or older.

Principal Life Insurance Company is the firm used to invest plan funds. Full Time employees contribute a mandatory 6.2% of their wages to this plan. Employer contributions are 6.2% of employee wages. These are the same contribution rates as the Social Security rates. Under this plan, employees are always 100% vested in their account.

Employees of the Authority not eligible to participate in this plan are covered by the Social Security system.

Risk Management

Michigan Municipal Risk Management Authority

The Authority participated in the public entity risk pool – Michigan Municipal Risk Management Authority (MMRMA) for auto and general liability, property and crime and vehicle physical damage coverage.

MMRMA, a separate legal entity, is a self-insured association organized under the laws of the State of Michigan to provide self-insurance protection against loss and risk management services to various Michigan governmental entities.

As a member of this pool, the Authority is responsible for paying all costs, including damages, indemnification, and allocated loss adjustment for each occurrence that falls within the member's self-insured retention (SIR). The Authority's SIR is between \$-0- and \$250. If a covered loss exceeds MMRMA's limits, all further payments for such loss are the sole obligation of the Authority. If for any reason, the MMRMA's resources available to pay losses are depleted, the payment of all unpaid losses of the Authority is the sole obligation of the Authority.

For the period July 1, 2003 through July 1, 2004, the Authority's coverage limits are \$5,000,000 for liability and from \$10,000 up to \$200,000,000 for property and crime. The expense recognized by the Authority for this type of risk management coverage for this time period totaled \$99,348.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Managed Care Risk Contract – The Authority has a managed care risk contract with the State of Michigan for State General Fund Formula Funding for priority populations. The Authority self-insures the risk for this contract with an Internal Service Fund risk reserve. The State General Fund risk contract and reserve covers only the Authority's specific service area. The contract provides for the use of contract funds to establish the risk reserve that is restricted to meet future risk obligations. Expenditures from the Internal Service Fund risk reserve may occur if, in any one fiscal year, the Authority finds it necessary to expend more than its then current resources to provide contractually obligated supports and services for eligible individuals.

Transfers to Affiliates

During the 2003 fiscal year, as part of the State's contractual consolidation of regional Medicaid specialty supports and services, the Authority was required to transfer \$606,213 of Medicaid risk reserve to an affiliate, Bay-Arenac Behavioral Health, as of October 1, 2002, including interest from that date to the date of transfer. The transfer represents a contractual transfer of equity to an affiliate.

Contingent Liabilities

Amounts received or receivable from federal, state and other grantor agencies are subject to audit and adjustment by the grantor. Any disallowed amounts, including amounts already collected, may constitute a liability. The amount, if any, of costs that may be disallowed cannot be determined at this time.

Depreciation expense was calculated in accordance with accounting principles generally accepted in the United States of America (GAAP), including, as required, depreciation on the restated value of capital assets in existence as of the implementation date of GASB 34, over their remaining useful lives. However, based on assertions made in other CMH audits, it is expected that State auditors will assert that depreciation on capital assets purchased prior to October 1, 2002 (pre-existing assets) is not allowable. The assertion in those cases has yet to be fully adjudicated or resolved. The Authority expects to be challenged by the Michigan Department of Community Health and intends to defend its position vigorously. The Authority contends that such treatment as asserted by State auditors is not in accordance with the Michigan Mental Health Code.

Tuscola County Community Mental Health Authority
Notes To Financial Statements
September 30, 2004

Subsequent Events

As of October 5, 2004, the Authority entered into a promissory note contract with Mayville State Bank in Mayville, Michigan for \$172,000 for the purchase of real property. Payments are due monthly in the amount of \$836, including interest at the rate of 4.15% per annum. Payments on this loan begin November 5, 2004.

REQUIRED SUPPLEMENTAL INFORMATION

Tuscola County Community Mental Health Authority
Statement of Revenues, Expenditures and Changes
in Fund Balance - Budget and Actual
General Fund
For the Year Ended September 30, 2004

	Budgeted Amounts			Variance Between Actual and Final Budget
	Original	Final	Actual	
REVENUES				
State grants				
State General Fund - MDCH Contract	\$1,827,202	\$1,666,163	\$1,823,895	\$157,732
Adult Benefit Waiver	10,000	193,228	178,032	(15,196)
Title XX	5,843	5,843	5,843	-
Total state grants	<u>1,843,045</u>	<u>1,865,234</u>	<u>2,007,770</u>	<u>142,536</u>
Federal grants	<u>306,379</u>	<u>220,317</u>	<u>176,650</u>	<u>(43,667)</u>
Contributions - local units				
County appropriations	<u>288,243</u>	<u>288,243</u>	<u>288,243</u>	<u>-</u>
Charges for services				
Medicaid - affiliate	9,795,261	10,484,050	10,420,308	(63,742)
Medicaid - other	85,000	59,171	70,380	11,209
Client and third party pay	203,600	221,341	211,763	(9,578)
Contract revenue	<u>173,000</u>	<u>119,031</u>	<u>176,010</u>	<u>56,979</u>
Total charges for services	<u>10,256,861</u>	<u>10,883,593</u>	<u>10,878,461</u>	<u>(5,132)</u>
Interest and rents				
Interest	<u>40,000</u>	<u>19,212</u>	<u>19,356</u>	<u>144</u>
Other revenue				
Cass Valley Enterprises	1,164,300	1,664,300	1,071,312	(592,988)
Other	<u>25,150</u>	<u>25,165</u>	<u>13,919</u>	<u>(11,246)</u>
Total other revenue	<u>1,189,450</u>	<u>1,689,465</u>	<u>1,085,231</u>	<u>(604,234)</u>
Total revenues	<u>13,923,978</u>	<u>14,966,064</u>	<u>14,455,711</u>	<u>(510,353)</u>
EXPENDITURES				
Health & welfare - mental health				
Personnel costs	6,293,847	6,196,896	6,315,941	(119,045)
Operating expenditures	7,229,326	8,396,622	8,071,542	325,080
Capital outlay	238,295	209,713	1,321,569	(1,111,856)
Debt service	<u>98,142</u>	<u>12,833</u>	<u>121,072</u>	<u>(108,239)</u>
Total expenditures	<u>13,859,610</u>	<u>14,816,064</u>	<u>15,830,124</u>	<u>(1,014,060)</u>
Excess of revenues over expenditures	<u>64,368</u>	<u>150,000</u>	<u>(1,374,413)</u>	<u>(1,524,413)</u>
Other financing sources (uses)				
Loan proceeds	-	-	529,369	529,369
Operating transfers out - internal service fund	<u>-</u>	<u>-</u>	<u>98,300</u>	<u>98,300</u>
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>627,669</u>	<u>627,669</u>
Excess of revenues and other sources over (under) expenditures and other uses	<u>64,368</u>	<u>150,000</u>	<u>(746,744)</u>	<u>(896,744)</u>
Fund balance, October 1	<u>1,625,660</u>	<u>1,625,660</u>	<u>1,625,660</u>	<u>-</u>
Fund balance, September 30	<u>\$1,690,028</u>	<u>\$1,775,660</u>	<u>\$878,916</u>	<u>(\$896,744)</u>

See Accompanying Notes To Financial Statements

OTHER SUPPLEMENTAL INFORMATION

OTHER SUPPLEMENTAL INFORMATION

Tuscola County Community Mental Health Authority
Supporting Schedule of Personnel Costs
For the Year Ending September 30, 2004 and 2003

	<u>General Fund</u>	
	<u>2004</u>	<u>2003</u>
Personnel Costs		
Salaries and wages	\$5,048,555	\$4,716,386
Fringe benefits	<u>1,267,386</u>	<u>1,093,214</u>
Total personnel costs	<u><u>\$6,315,941</u></u>	<u><u>\$5,809,600</u></u>

See Accompanying Notes To Financial Statements

Tuscola County Community Mental Health Authority
Supporting Schedule of Operating Expenditures
For the Year Ending September 30, 2004 and 2003

	General Fund	
	2004	2003
Operating Expenditures		
Client Activities	\$50,489	\$32,464
Communications	95,784	134,467
Contractual Services	4,048,866	4,044,234
Institutional And State Residential Care	411,509	393,367
Insurance	315,092	189,859
Janitorial Services	8,293	29,846
Local Funds Contribution	282,805	282,805
Other	98,279	72,588
Outpatient Services	8,323	6,474
Prescription Drugs	22,180	16,053
Private Hospitalization	473,937	365,665
Printing And Publishing	48,733	50,324
Raw Materials	847,742	1,885,263
Rental Expense	483,225	489,687
Repairs And Maintenance	165,533	117,546
Respite Sitter	18,095	23,803
Supplies	492,193	317,512
Travel	101,104	107,772
Utilities	99,360	79,742
Total Operating Expenditures	<u>\$8,071,542</u>	<u>\$8,639,471</u>

See Accompanying Notes To Financial Statements



**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Tuscola County Community Mental Health Authority
Caro, Michigan

We have audited the basic financial statements of the Tuscola County Community Mental Health Authority as of and for the year ended September 30, 2004, and have issued our report thereon dated November 17, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Tuscola County Community Mental Health Authority's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Tuscola County Community Mental Health Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Tuscola County Community Mental Health Authority, in a separate letter dated November 17, 2004.

This report is intended solely for the information and use of the audit committee, management, others within the organization, and the Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.

Roslund, Prestage & Co, PC
Roslund, Prestage & Company, P.C.
Certified Public Accountants

November 17, 2004



MANAGEMENT LETTER

Board of Directors
Tuscola County Community Mental Health Authority
Caro, Michigan

In planning and performing our audit of the financial statements for Tuscola County Community Mental Health Authority, for the fiscal year ended September 30, 2004, we considered the internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters.

This letter does not affect our audit report dated November 17, 2004 on the financial statements of Tuscola County Community Mental Health Authority.

We will review the status of these comments during our next audit engagement. We have discussed these comments and suggestions with management, and will be pleased to discuss them with you in further detail, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Sincerely,

Roslund, Prestage & Company, P.C.
Certified Public Accountants

November 17, 2004

ROSLUND, PRESTAGE & COMPANY, P.C.
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3-4055

General Fund – Negative Unreserved Fund Balance

Under the Uniform Budget and Accounting Act, the Authority is required to maintain a positive, unreserved fund balance for each of its funds. As of year end, the general fund reported a negative, unreserved fund balance amount.

The reason this arose is because \$1.32 million of equipment and real estate was purchased during the year, which was financed with \$530 thousand of debt and \$790 thousand of cash. When reporting under the modified accrual basis of accounting, this cash disbursement reduces unreserved fund balance. However, it is important to note that as of year end, fund balance in total was a positive amount and all components of net assets were positive. Additionally, subsequent to the balance sheet date, the Authority has developed a corrective action plan that addresses this issue.

We recommend management monitor all components of fund balance on a regular basis, and prevent this issue from occurring again in the future.

Perform a Fraud Risk Assessment

In light of the wave of notorious frauds involving large companies in the last few years, such as Enron, WorldCom, and HealthSouth, there may be a misperception that fraud affects only large companies. However, fraud occurs in companies of all sizes, and almost any employee may be capable of perpetrating a fraudulent act given the right set of circumstances. In fact, fraud may be a more significant problem for small companies. In the 2002 survey of its members conducted by the Association of Certified Fraud Examiners (ACFE), the median loss per fraud occurrence reported from businesses with 100 or fewer employees was \$127,500, a proportionately larger loss than the \$97,000 median loss in companies with 10,000 or more employees.

Whereas the highly publicized frauds at large public companies like Enron, WorldCom, and HealthSouth involved fraudulent financial reporting, for small companies, one of the primary fraud risks is the ever-present risk of misappropriation of assets (theft), particularly fraudulent cash disbursements. The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and there are inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the Authority perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the Authority's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

Perform a Fraud Risk Assessment (continued)

During our audit, we have reviewed and tested the Authority's internal control system, and found no indication that fraud has occurred. However, a fraud risk assessment should be performed on a regular basis to timely identify any changes needed in the Authority's internal control system.

This assessment can be informal and performed by a management-level individual. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the Authority, its environment, and its processes. The fraud risk assessment process should consider the Authority's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

- Which individuals in the Authority have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- Are there any known pressures that would motivate individuals with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of individuals with access to assets susceptible to misappropriation.
- What assets of the Authority are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious individuals or vendors and cashing them for personal use. Inventory or other assets can be stolen through sales to fictitious customers.
- How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running it through as an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.
- What factors might indicate that the Authority has a culture or environment that would enable management or individuals to rationalize committing fraud?

Perform a Fraud Risk Assessment (continued)

Once areas vulnerable to fraud have been identified, a review of the Authority's systems, procedures, and existing controls relating to the identified areas should be conducted. The Authority should consider what additional controls need to be implemented to reduce the risk of fraud. There are two basic types of controls—those that are designed to address specific types of fraud, and those that are more general in nature. General controls that reduce an individual's ability to commit fraud without detection include the following:

- Requiring Periodic Job Rotation and Mandatory Vacations. When an employee stays in the same position for a long period and has few absences, an opportunity exists for that employee to design and commit fraud schemes. Requiring key individuals to rotate jobs periodically or to transfer to different job functions is one way to address this fraud risk. Requiring all individuals to take an annual vacation, during which time others perform their job functions, also makes it more difficult for an employee who is committing fraud to continue concealing the fraud scheme.
- Preparing and Reviewing Monthly Financial Statements in a Timely Fashion. As previously mentioned, many frauds create accounting anomalies. Thus, one way to detect fraud on a timely basis is to review monthly financial statements and investigate unusual variances. If possible, these statements should include budget, prior period, and year-to-date amounts to help identify variances. Performing the review and investigation on a timely basis helps minimize the extent of potential fraud.

Examples of controls to prevent or detect specific types of fraud include the following:

- Independent Checks of work performed. Independent checks test another employee's work, such as by having a second employee re-perform or test an employee's work.
- Separation of Duties. Separation of duties is one of the most effective controls to prevent or detect misappropriations of assets. When possible, incompatible duties should be performed by different employees. For example, the responsibility for authorizing transactions, recording transactions, and maintaining custody of assets should be assigned to different people in the Authority to the extent possible.

When assessing the Authority's internal control, the relationship between the nature and extent of fraud controls recommended and the cost of implementing those controls should be considered. For example, instead of trying to prevent fraud, the Authority may choose to use more detective controls to ensure that the fraud is identified and corrected in a timely fashion. Because detective controls are performed after the original transaction occurs, they may be easier to implement and more cost effective. We would be pleased to provide more information about performing a risk assessment or assist management in performing one.

Review Payroll Records for Unusual Matters

Performing a careful review of the payroll register (that is, the schedule showing the calculation of gross pay, deductions, and net pay) and payroll check register can highlight several types of payroll fraud. We recommend that an appropriate person periodically make such a review, being alert for unusual matters that might suggest fraud, such as the following:

- Duplicate names or addresses.
- Names of former employees.
- Math errors (which may indicate diversion of payroll or payroll taxes).
- Unusual pay rates or numbers of hours worked.
- Factors that may indicate ghost employees.